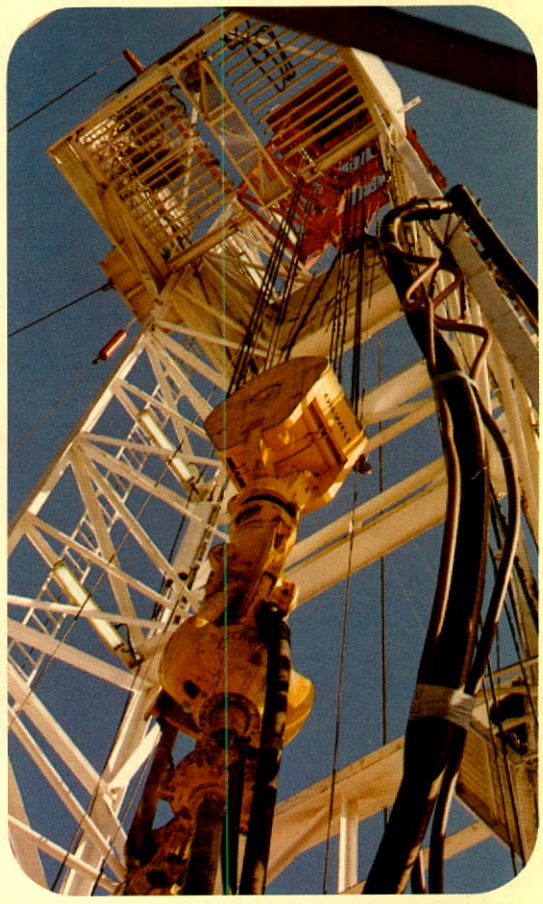
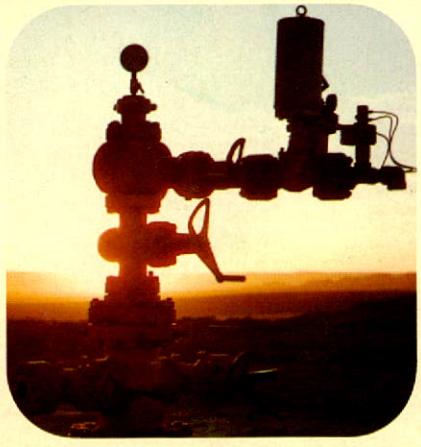
RANCHMEN'S RESOURCES (1976) LTD.

ANNUAL REPORT 1977





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HEAD OFFICE
550 Daon Building
444 Fifth Avenue S.W.
Calgary, Alberta, T2P 2T8

SUBSIDIARY COMPANIES
Bluemount Minerals Ltd.
Bluemount Minerals, Inc.
Brady Oil and Gas Limited

TRANSFER AGENT
Montreal Trust Company
411 Eighth Avenue S.W.
Calgary, Alberta

BANKERS
The Royal Bank of Canada
Main Branch
339 Eighth Avenue S.W.
Calgary, Alberta

AUDITORS
Peat, Marwick, Mitchell & Co.
2500, 700 Second Street S.W.
Calgary, Alberta

SOLICITORS
Howard, Dixon, Mackie & Forsyth
Third Floor, One Calgary Place
330 Fifth Avenue S.W.
Calgary, Alberta

STOCK EXCHANGE LISTING
Alberta Stock Exchange

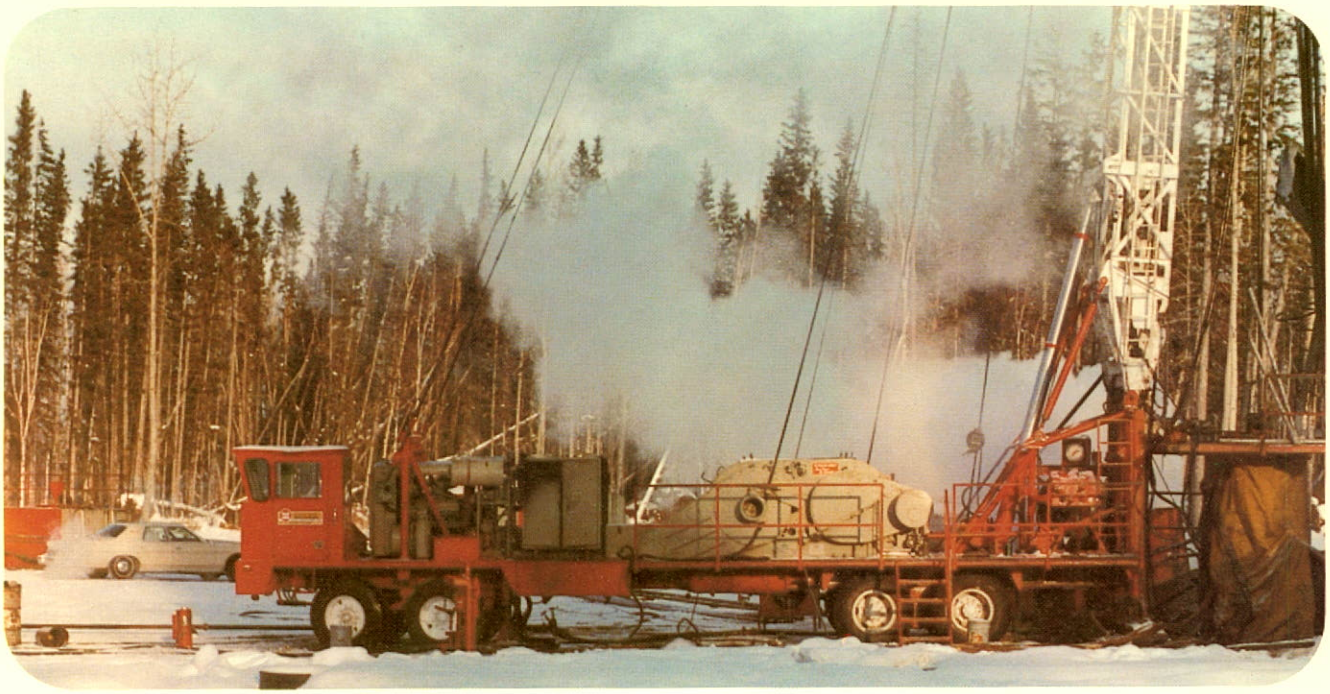
DIRECTORS AND OFFICERS
R. W. Andrew, Calgary
G. R. Bongard, Toronto
W. R. Gulliver, Calgary
P. N. Holtby, Toronto
W. A. Howard, Calgary
J. G. McDonald, Calgary
J. S. Poyen, Calgary
W. Scott, Tulsa, Oklahoma
H. N. Stewart, Calgary
R. J. White, Calgary

President
R. J. White

Vice President & Treasurer
J. G. McDonald

Secretary
R. G. Powers

The Annual Meeting of the Company will be held at the Lakeview Room, Calgary Inn, 320 - 4th Avenue S.W., Calgary on Monday, May 29, 1978 at 10 a.m. local time. The Notice of Meeting is enclosed with this report.



1977 Highlights

	Year Ending December 31, 1977
FINANCIAL RESULTS	
Gross Sales	**$ 5,052,416**
Cash Flow from Operations	**1,204,165**
Per Share	**0.88**
Net Loss	**292,576**
Per Share	**0.22**
Working Capital deficiency	**883,846**
Long Term Debt	**11,622,810**
Capital Expenditures	**2,730,607**
Total Common Shares Outstanding	**1,367,934**
OPERATING RESULTS	
Production	
Oil (barrels per day)	**432**
Gas (million cubic feet per day)	**7.612**
Net Proved and Probable Reserves	
Oil (barrels)	**2,088,378**
Gas (billion cubic feet)	**30.189**
Oil and Gas Lands	
Gross Acres	**824,719**
Net Acres	**209,715**

R. J. White

J. G. McDonald

Report of the Directors to the Shareholders

I am pleased to present our report on the first full year's operation of your Company following the amalgamation. Also included are an unaudited earnings statement and a report on operations for the first quarter of 1978.

First Quarter 1978

For the convenience of shareholders, the unaudited Statement of Earnings for the first three months is presented comparatively with the same period in 1977 (See page 4). Gross Revenues were $1,328,074, an increase of $199,554 over the same period a year ago and cash flow from operations increased by $173,346 to $456,371. Net profit for the period was $16,371, compared to a net loss of $361 for the same period last year.

Financial

Net revenue of the Company in 1977 was $3,905,986 and total expense $4,198,562 resulting in a net loss of $292,576 ($0.22 per share). Cash flow from operations was $1,204,165 ($0.88 per share) and capital expenditures for the year were $2,730,607.

The working capital deficiency of $1,477,692 at the beginning of the year was reduced to $883,846 at year-end. Additional comments on the financial report are included on Page 5.

Corporate Refinancing

The sale of $10,000,000 Floating Rate Secured Serial Income Debentures was the corporate highlight of the year. Proceeds of the offering were used to reduce our bank loan and retire other indebtedness. The principal amount matures in five equal instalments, commencing December 22, 1981 through December 22, 1985. Interest payable floats at 50% of the prime bank rate plus 1.5% with a minimum of 5.5% and a maximum of 7.5%. The debentures are secured by oil and gas properties. The Company has issued purchase warrants to the debenture holders for 100,000 Class 'A' Common shares at prices ranging from $3.50 to $5.00 per share.

Partnerships

In 1976 we completed the formation of a Partnership to finance the development of properties of Bluemount Resources Ltd. A total of $8,000,000 was raised by the Partnership and private investors who, together, purchased a 27.83% working interest. A second Partnership formed in 1977 raised an additional $8,335,000 and acquired a 16.66% working interest in the lands.

The Company still retains a 55.51% working interest in most of the former Bluemount lands following the sale of interests to the two Partnerships.

Development Program

Much of our efforts in 1977 were directed to the development of gas and oil reserves in the Kessler-Provost and Amisk project areas of East Central Alberta. Seven wells were drilled in the Amisk area resulting in four oil wells and three dry holes. In the Kessler-Provost area two gas wells

were drilled. The Company's share of total capital spent on these two projects was $1,179,000.

The Kessler-Provost project involved the construction of a small gas plant and three satellite compressor stations with related facilities. Nine gas wells were brought on stream at various times during the year and four more will be added shortly.

At Amisk, two existing wells and the four new wells were placed on production and permanent battery facilities are nearing completion.

Operations Review & Forecast

The Company participated in 52 wells during the year, 34 of which were successful shallow gas wells at Medicine Hat #4 and West Hilda. Of the remaining 18, nine are gas wells, four are oil, and five were abandoned. Of three farmout wells, two are gas and one is a dry hole.

We are tentatively planning to drill ten wells on Company-operated lands during the year. Seven are located in East Central Alberta and three in the western part of the province. We continue to experience well scheduling problems due to the shortage of drilling rigs.

Production, Reserves, and Value

Production of gas and oil for the year was 2.778 billion cubic feet and 157, 662 barrels, respectively.

Recent evaluations of the Company reserves by independent consultants show net proven and probable reserves of gas at 30.189 billion cubic feet and oil reserves of 2,088,378 barrels. The value of the oil and gas reserves at varying discount rates is summarized on Page 8.

Current Outlook

Exploration and development activity in Alberta and British Columbia has continued at an active pace during the past year, but shortage of drilling equipment will continue to present problems for operators in the near term.

Drilling success over the past year has resulted in the development of substantial new reserves of natural gas. By comparison, discovery of new oil reserves has been less important and the gas industry success has created new problems for the producer.

For nearly two years now, the over-supply problem, coupled with soft demand for gas, has reduced the earning potential of gas producers. Many companies with deliverability contracts have suffered reduction of production varying from minor cutbacks to complete shut-downs of up to 75 days. Although most of our gas reserves are under contract, the Company continues to absorb its share of this reduction in gas revenue.

The recent request by TransCanada PipeLines Ltd. of a voluntary 20% cut-back by industry emphasizes the severity of the problem. In our view, continuing pressure from the producing sector along with monetary problems resulting from the balance of trade deficit, will force a political decision in favour of additional exports of natural gas to the United States. The ability of industry to find and develop new gas supplies has been seriously underestimated and the potential of the Canadian market to absorb increased available gas has been grossly exaggerated.

New Director

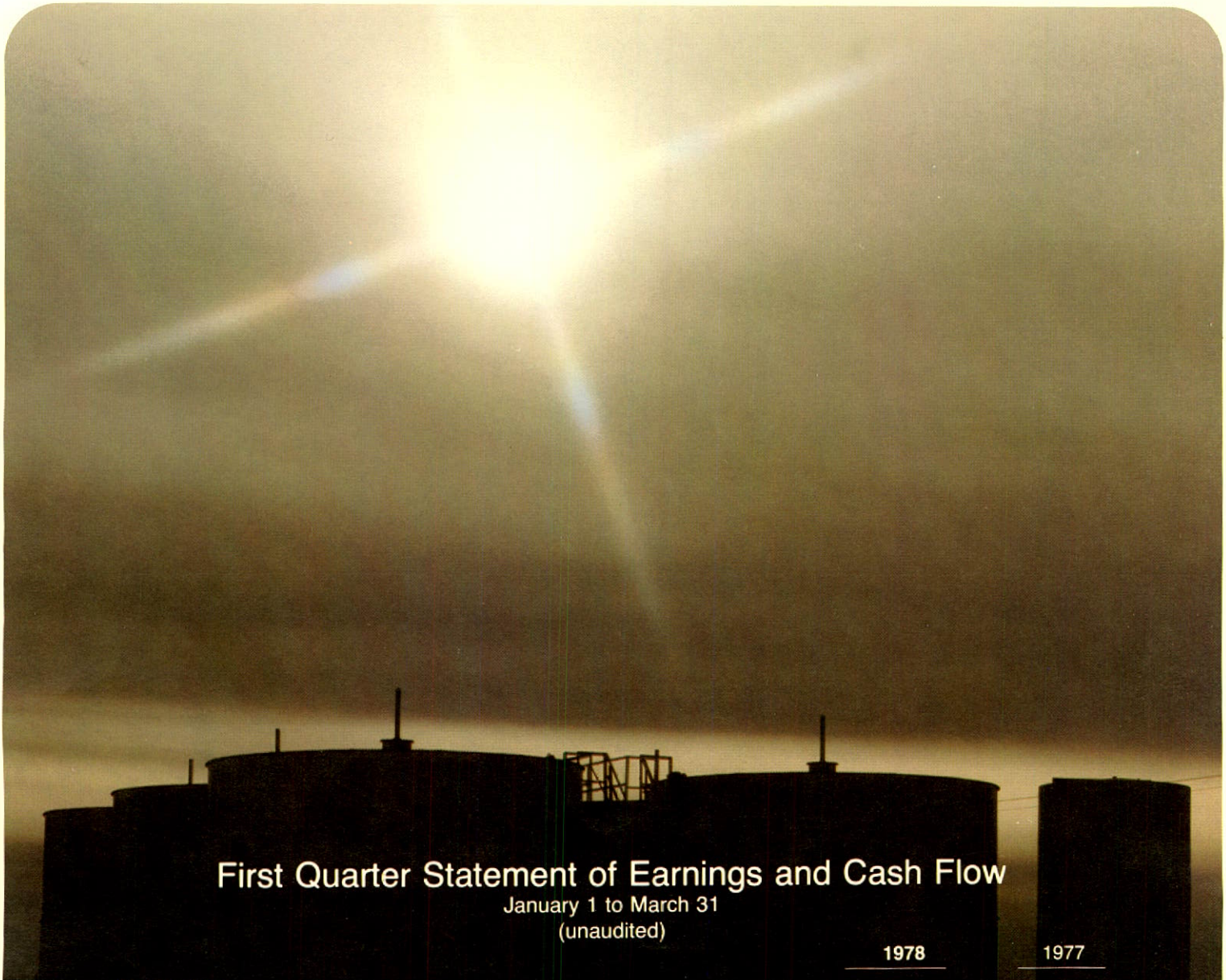
We are pleased to advise that Mr. J. S. Poyen was appointed to the Board of Directors on January 6, 1978. Mr. Poyen has been employed in an executive capacity in the oil industry for many years and more recently was President and General Manager of the Canadian Petroleum Association. Other members of the Board welcome his appointment and the contribution he will make to the continuing growth of the Company.

Thanks to the Staff

The Directors gratefully acknowledge the excellent support of the employees during the past year. The success of this challenging venture depends upon the continuing efforts of all.

On behalf of the Board of Directors

R. J. White
President



First Quarter Statement of Earnings and Cash Flow

January 1 to March 31
(unaudited)

	1978	1977
Production:		
Oil (barrels)	32,558	39,755
Natural Gas (thousand cubic feet)	682,080	582,947
Revenues:		
Gross Sales	$1,328,074	1,128,520
Royalties Paid (Net of Alberta Royalty Tax Credit)	347,143	314,845
Net Sales	980,931	813,675
Other	16,921	25,476
	997,852	839,151
Expenses:		
Production	184,196	117,915
General and administrative	147,077	117,405
Depreciation, depletion and amortization	305,000	244,686
Interest	210,208	320,806
	846,481	800,812
Profit before income taxes	151,371	38,339
Deferred Income Taxes	135,000	38,700
Net Profit (Loss)	$ 16,371	(361)
Net Profit (Loss) as above	$ 16,371	(361)
Add items not requiring working capital	440,000	283,386
Cash Flow from operations	$ 456,371	283,025
Cash Flow per share	$ .33	.20

FINANCIAL

Operating results for the full year are summarized as follows:

Sales of Natural Gas and Crude Oil		$5,052,416
Net Revenue		$3,905,986
Expenses — Cash	$2,701,821	
— Non-Cash	1,496,741	
Total	$4,198,562	
Net Loss for the year		$ 292,576
Per Share		$ 0.22
Cash Flow from Operations		$1,204,165
Per Share		$ 0.88
Capital Expenditures		$2,730,607

Interest expense, which amounted to $1,356,039, represents almost half of cash expense with the remaining 50% being split equally between Operating and General and Administrative expense. However, in 1978, as a result of the corporate refinancing, we anticipate a reduction of interest expense in the order of $500,000.

The Non-Cash portion of 1977 expense is mainly the depletion provision ($1,106,544) but also includes lesser amounts of depreciation, amortization and deferred income taxes.

Gradually increasing production revenue throughout the year resulted in an overall reduction of the working capital deficit from $1,477,692 to $883,846.

As a result of the corporate refinancing and additional bank borrowings, the long-term debt was increased by $15,182,625; however, it was correspondingly reduced by $15,450,116. This reduction was made possible by the refinancing and by the sale of oil and gas properties, particularly by the sale to Redpar (1977).

The Term Debenture in the amount of $400,000 bearing interest at 3% over prime was retired from the proceeds of the newly issued Income Debentures.

Advances to Class 'B' shareholders increased by $455,205 from $630,457 at the beginning of the year to a total of $1,085,662. This amount was offset by dividends paid of a like amount. Total dividends paid to Class 'B' shareholders over the past two years was approximately $1,200,000 and these shares will not receive any further dividends until Class 'A' and Class 'C' have received a total of $1,500,000.

Capital Expenditures

A total of $2,730,607 was spent in 1977 on drilling, land, and further development of existing producing properties. Most of these funds were used at Kessler-Provost where nine wells were drilled, a small plant constructed, and three compressor stations with connecting flow lines installed. Ranchmen's share of this expense was $1,179,000. The acquisition and maintenance of non-producing lands required $398,000 and at Medicine Hat #4, a further $399,000 was required for our share of new wells and related facilities. The remaining capital was used for our share of surface facilities at Rosalind, Deer Mountain and West Taber; and the drilling of seven wells at Granor, Horizon, Nestow, Vegreville and Killam.

Income Debenture

The most important financial transaction during the year was through the private placement of $10,000,000 Floating Rate Secured Serial Income Debentures. The basic terms of this debt instrument are:

1. *Form* — issued in five series of $2,000,000 principal amount, each maturing as follows:
   Series 'A' — December 22, 1981
   Series 'B' — December 22, 1982
   Series 'C' — December 22, 1983
   Series 'D' — December 22, 1984
   Series 'E' — December 22, 1985
2. *Interest* — rate equal to 1.5% per annum plus one-half of the Prime Rate with a minimum of 5.5% and a maximum of 7.5% payable semi-annually on June 30 and December 31.
3. *Redemption* — The Debentures are redeemable at the option of the Company on or after December 19, 1979, with accrued interest to the date of redemption.
4. *Security* — First mortgage on defined producing oil and gas properties.
5. *Share Purchase Warrants* — The Company has issued warrants entitling the subscriber to purchase 100,000 shares of the Company at the purchase price of:
   (a) $3.50 per share at any time prior to December 19, 1979;
   (b) $4.00 per share at any time from December 19, 1979 to December 19, 1981;
   (c) $5.00 per share at any time from December 19, 1981 to December 19, 1983.

Oil and Gas Programs

In 1976, Ranchmen's acquired control of Bluemount Resources Ltd. which subsequently became one of the amalgamating companies resulting in the formation of the present Company. Bluemount owned approximately 250,000 acres of oil and gas rights consisting of undeveloped lands and proven gas and oil reserves. None of the oil and gas properties were on stream and nearly all required new capital to complete the projects. In order to finance the purchase of the company and to provide capital for development, public partnerships were formed in successive years.

Ranchmen's Exploration & Development Partnership (1976) — Redpar (1976) and a group of private investors raised a total of $8,000,000. The following year, Ranchmen's Exploration & Development Partnership (1977) — Redpar (1977), was successful in raising $8,335,000.

In most properties, Redpar (1976) and the private investors own a 27.83% working interest and Redpar (1977) owns 16.66% leaving a 55.51% working interest in the Company.

Summary of Partnership Funding

	Redpar (1976) & Private Investors	Redpar (1977)
Funds Raised	$8,000,000	$8,335,000
Applied to Purchase	$3,400,000	$2,864,000
Development Costs at December 31, 1977		
— Spent	$1,800,000	—
— Available	$2,300,000	$4,816,000
Commission and Organization Costs	$ 450,000	$ 577,000
Total Partners	216	542

Under the terms of a Farmout Agreement between Redpar (1977) and the Company, the Partnership will pay twice its share of drilling and completion costs and in return, will increase its working interest by 50% in specified lands. The company's working interest in these lands will be reduced by the same amount.

The Farmout Agreement expires June 30, 1980, following which Redpar (1977) will participate only to the extent of its working interest.

Redpar (1976) and the private investors will continue to participate to the extent of their current 27.83% interest.

OPERATIONS

Kessler-Provost

Our most important operational activity during the year was the installation of production facilities at Kessler-Provost to bring shut-in gas wells into production. This included an auto-refrigeration plant adjacent to the sales outlet which is supplied by three satellite compressor stations. Total cost of the facility and two new wells was $1,788,000 of which Ranchmen's share was $1,061,000.

A total of nine wells were brought on stream during spring and early summer. Five wells were tied into the compressor at Choice, three were connected to the Ribstone compressor, and one at Craigmiller. A total of 24 miles of 4" and 6" gathering lines were installed. Following spring break-up this year an additional four wells will be connected to the system at Choice (See map Page 9), bringing the total number of producing gas wells to 13.

During the spring and summer of 1977, two additional wells were drilled and completed as gas wells in the project area. Ranchmen's et al Provost 10-29-39-8 W4M is now producing into the Choice station and Ranchmen's et al Provost 7-17-39-8 W4M was completed as a gas well and is currently shut-in awaiting gas contract. Working interest in these two wells is 24.43% and the working interest in the other 14 wells in the project varies from 24.43% to 55.51%.

Amisk

Simultaneous with gas development at Kessler-Provost (See map), the Company was actively developing its oil discovery at Amisk. An oil show in an earlier well drilled in 10-22-39-8 W4M was followed in late 1976 by a successful step out in 6-26-39-8 W4M.

During the early months of 1977, seven additional wells were drilled in the immediate area resulting in four oil wells and three dry holes. Since that time, a central production facility was constructed which now services the six producing wells. The total cost of drilling and completing these wells was $613,000 with a further $201,000 being invested in the surface facilities. Ranchmen's shares of these costs was $55,000, and $63,000, respectively. Following the sale of 16.66% to Redpar (1977), the Company retains working interests varying from 17.47% to 55.51%.

Rosalind

A map of the Rosalind project is displayed on Page 9. Company interests vary from 27.76% to 55.51% in 20,160 acres and include seven com-

pleted Belly River gas wells and one suspended Viking oil well which will be completed shortly.

A gas plant was constructed in 1976 and commenced production in September of that year. Four wells are connected to the facility which is capable of processing up to three million cubic feet per day.

Medicine Hat #4

The Company owns a working interest of 23.5% in 9,760 acres of land with rights to both Milk River and Medicine Hat zones and a further 13,280 acres of Milk River rights only. During the year an additional 21 wells were drilled, completed and tied into the system bringing the total number of producing wells to 82.

Deer Mountain

Three of the four wells in this area produced intermittently throughout the year. The fourth well, previously suspended because of surface mechanical problems, has now been restored to production.

Difficult terrain in this area does not allow continuous production with the current temporary facilities. Permanent battery and flow lines will be installed later in the year. Further development activity planned for this year includes the drilling of two more wells and the construction of a portion of the permanent production facilities.

Nestow

The Company owns a 16.66% interest in two wells and a 2.5% royalty in a third well which reverts to 8.33% working interest after payout. All three wells are currently producing from the Basal Quartz, Upper Mannville and Viking Zones. The discovery well in 11-23-60-24 W4M drilled in 1977 produces from the Viking. The 8.33% interest well produces from the Basal Quartz.

Five miles south of the plant, a second well drilled in 7-25-59-24 W4M in late fall of 1977 was completed as a Glauconitic gas well. Two offsets to this discovery well were drilled in early 1978. One in 11-24-59-24 W4M is an indicated Colony gas well and the second in 7-26-59-24 W4M was a dry hole.

1978 Activity

The Company recently participated in the drilling of a successful Viking gas well in 10-11-41-11 W4M near Thompson Lake and retains a 23.59% interest. We plan to participate in seven more wells in East Central Alberta during the early summer. This program includes four oil prospects and three gas tests on lands already under contract.

We recently obtained a drilling license for Ranchmen's et al Airdrie 6-11-27-1 W5M. This 7,800 foot test, located just north of Calgary, is scheduled to evaluate all zones down to and including the Elkton Formation. Company interest in the spacing unit varies from 20.8% to 55.5% working interest.

During the fall of 1977, the Company and Redpar (1976) farmed out a 25% interest in a 5,120 acre block in the Berland River area of West Central Alberta. The earning well, Gulf et al Wild River 10-9-57-24 W5M, commenced drilling in mid January and will finish during May.

Well Drilling Summary

	% Company Interest	Oil	Gas	Dry
Company Participation				
Amisk	34 - 41	4	—	3
Kessler-Provost	41	—	2	—
Killam	41	—	1	1
Medicine Hat #4	23.5	—	21	—
West Hilda	8.7	—	13	—
Granor	6.25	—	2	—
Horizon	2.5	—	1	—
Vegreville	5.5 - 11.5	—	1	1
Nestow	16.6	—	2	—
Company Farmout				
Chigwell	27.7	—	1	1
Nestow	8.3	—	1	—
Total		4	45	6

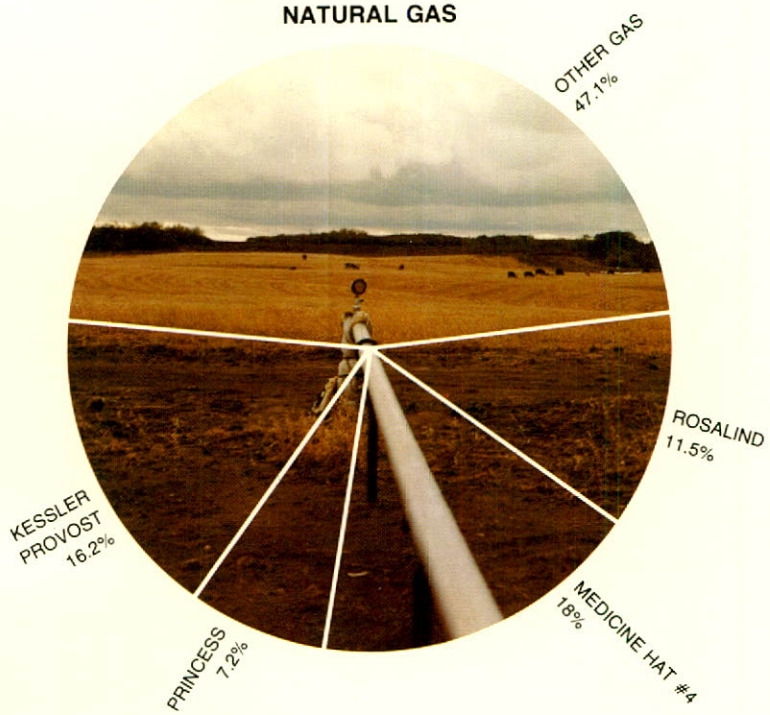
RANCHMEN'S RESOURCES (1976) LTD.

CRUDE OIL

SUMMARY OF NET RESERVES

Property	Proven		Proven plus Probable Additional	
	Oil (barrels)	Gas (billion cubic feet)	Oil (barrels)	Gas (billion cubic feet)
Amisk	131,176		168,594	
Deer Mountain	248,602		1,281,412	
Provost Project 10	99,551		144,679	
Other Oil	474,623		493,693	
Kessler Provost		4.099		5.276
Princess		1.808		1.808
Medicine Hat #4		4.588		4.588
Rosalind		2.945		3.634
Other Gas		11.960		14.883
Total	953,952	25.400	2,088,378	30.189

NATURAL GAS

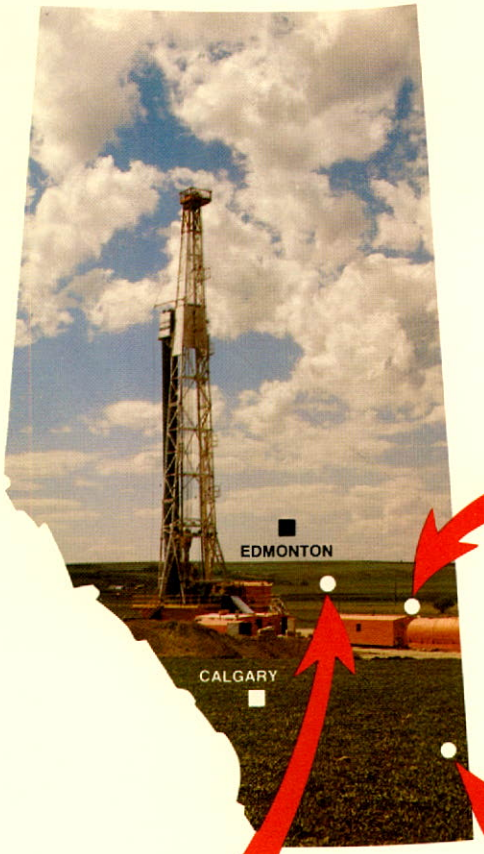


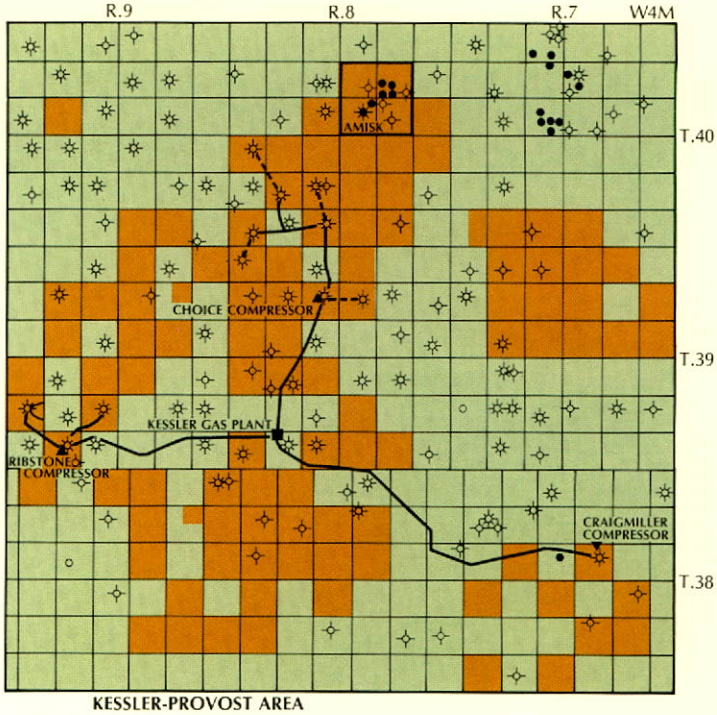
CASH FLOW SUMMARY

Proven plus Probable Reserves
(thousands of dollars)
Discounted at

Property	0%	9%	15%	20%
Oil				
Amisk	$ 1,523	$ 799	$ 573	$ 453
Deer Mountain	14,714	3,565	1,752	955
Provost 10	1,518	1,007	811	694
Other	6,523	3,617	2,852	2,446
Sub-Total	$24,278	$ 8,988	$ 5,988	$ 4,548
Gas				
Kessler Provost	9,926	5,285	3,874	3,127
Princess	3,361	1,430	980	766
Medicine Hat #4	8,277	4,526	3,350	2,728
Rosalind	7,826	4,690	3,617	3,015
Other	28,378	13,045	9,434	7,645
Sub-Total	$57,768	$28,976	$21,255	$17,281
Total	$82,046	$37,964	$27,243	$21,829

Reserves and discounted cash flow information shown above is summarized from independent engineering evaluations as of December 31, 1977. These evaluations also include a fair market value of $2,086,457 for the company's undeveloped lands.





KESSLER-PROVOST AREA

RANCHMEN'S WORKING INTERESTS FROM 24.43% to 55.51%

• OIL WELL ✲ GAS WELL ○ LOCATION

✧ ABANDONED WELL ✷ OIL & GAS WELL

— GATHERING SYSTEM — EXISTING

--- GATHERING SYSTEM — PROPOSED

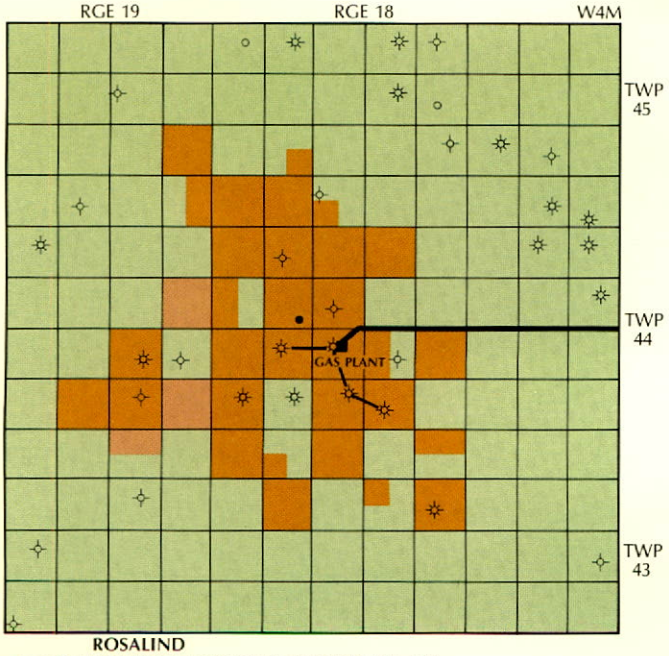
MEDICINE HAT PROJECT NO. 4

RANCHMEN'S WORKING INTEREST 23.50% (ALL RIGHTS EXCLUDING MED. HAT)

RANCHMEN'S INTEREST LANDS (ALL RIGHTS)

✲ GAS WELL ✧ ABANDONED WELL

— GATHERING SYSTEM — EXISTING



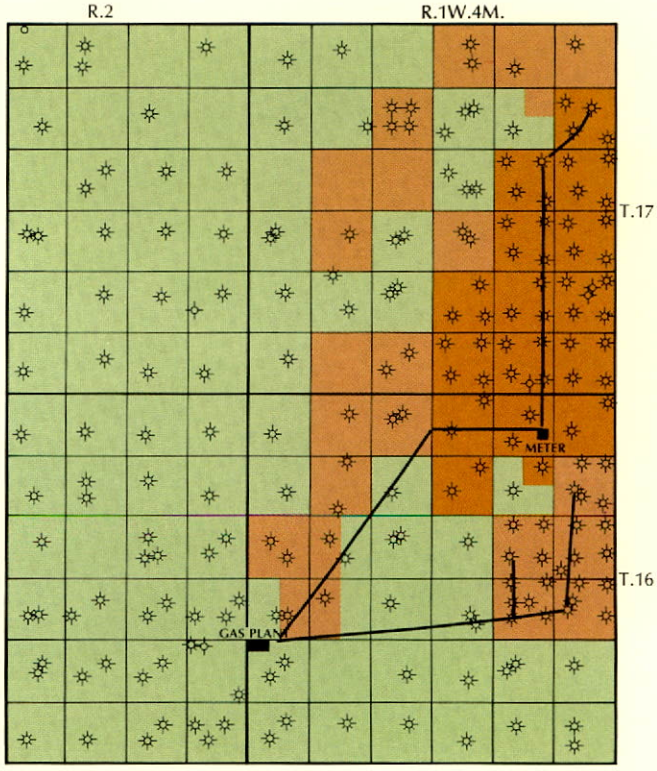
ROSALIND

RANCHMEN'S WORKING INTEREST 55.51%

RANCHMEN'S WORKING INTEREST 27.76%

✲ GAS WELL ✧ ABANDONED WELL • OIL WELL ○ LOCATION

— GATHERING SYSTEM — SALES GAS LINE



RANCHMEN'S RESOURCES (1976) LTD.

Consolidated Balance Sheet

DECEMBER 31, 1977
(with comparative figures at January 4, 1977)

Assets

	December 31	January 4
Current assets:		
Cash	**$ 443,716**	—
Accounts receivable	**1,073,965**	2,244,708
Marketable securities, at cost	**—**	59,075
Inventory of material and supplies, at cost	**123,495**	183,657
Total current assets	**1,641,176**	2,487,440
Non-current investments and receivables:		
Mortgages receivable, net of current portion	**271,029**	276,786
Real estate held for resale, at cost	**373,690**	363,415
Due from Class "B" Common Shareholders	**—**	630,457
	644,719	1,270,658
Property and equipment, at cost less depreciation and depletion:		
Oil and gas properties	**16,671,077**	17,949,039
Production equipment	**2,099,633**	1,177,669
Office equipment	**69,391**	11,950
	18,840,101	19,138,658
Less accumulated depreciation and depletion	**1,283,016**	—
	17,557,085	19,138,658
Other assets:		
Unamortized financing expenses	**395,146**	305,343
Sundry, at cost	**116,081**	77,547
	511,227	382,890
	$20,354,207	23,279,646

Approved on behalf of the Board:

R J White, Director

, Director

See accompanying notes.

Liabilities and Shareholders' Equity

	December 31	January 4
Current liabilities:		
Outstanding cheques less cash on deposit	**$ —**	400,020
Accounts payable and accrued liabilities	**1,573,672**	2,106,750
Notes payable, unsecured	**—**	756,106
Current portion of long-term debt	**951,350**	702,256
Total current liabilities	**2,525,022**	3,965,132
Long-term debt (Note 2):		
Bank loans — net of current portion	**1,587,504**	10,902,525
Term debenture	**—**	400,000
Income debentures	**10,000,000**	—
Due to parent company, Canadian Oil & Gas Fund Ltd.	**—**	543,442
Mortgage payable, net of current portion	**35,306**	44,334
	11,622,810	11,890,301
Deferred income taxes	**406,074**	234,074
Minority interest in subsidiary	**3,423**	3,423
Shareholders' equity:		
Share capital (Note 3):		
Preferred shares with a nominal or par value of $10 per share		
Authorized: 1,400,000 shares		
Issued: 14,500 Series "B" 8% Convertible		
Cumulative Redeemable Preferred Shares	**145,000**	145,000
Common shares without nominal or par value		
Authorized 5,000,000 shares divided into		
4,400,000 Class "A" Common Non-Voting Shares		
300,000 Class "B" Common Non-Voting Shares		
300,000 Class "C" Common Voting Shares		
Issued: 1,070,070 Class "A" Common Non-Voting Shares	**4,512,085**	4,512,085
227,602 Class "B" Common Non-Voting Shares	**1,138,012**	1,138,012
70,262 Class "A" Common Voting Shares	**351,312**	351,312
Contributed surplus	**1,737,590**	1,737,590
Deficit	**(2,087,121)**	(697,283)
	5,796,878	7,186,716
Commitment and contingent liabilities (Note 4)	**$20,354,207**	23,279,646

See accompanying notes.

RANCHMEN'S RESOURCES (1976) LTD.

Consolidated Statement of Earnings and Deficit

From date of amalgamation,
January 4, 1977, to December 31, 1977

Revenues:	
Sales of natural gas and crude oil	**$5,052,416**
Less royalties (net of Alberta Royalty Tax Credit of $258,190)	**1,307,562**
Production revenue	**3,744,854**
Other	**161,132**
	3,905,986
Expenses:	
Operating	**680,041**
General and administrative	**457,760**
Expenses of assessing corporate acquisitions	**84,468**
Outside consulting fees	**123,513**
Depreciation	**158,000**
Depletion	**1,106,544**
Amortization of financing expenses	**60,197**
Interest — long-term debt	**1,332,206**
— other	**23,833**
	4,026,562
Loss before deferred income taxes	**120,576**
Deferred income taxes (Note 7)	**172,000**
Net loss	**292,576**
Deficit, beginning of period	**697,283**
Dividends paid on Class "B" Common Shares	**1,085,662**
Dividends paid on Preferred Shares	**11,600**
Deficit, end of period	**$2,087,121**
Loss per share	**$ .22**

See accompanying notes.

RANCHMEN'S RESOURCES (1976) LTD.

Consolidated Statement of Changes in Financial Position

From the date of amalgamation,
January 4, 1977, to December 31, 1977

Source of funds:	
Operations:	
Net loss	**$ 292,576**
Add items not requiring working capital:	
Depreciation	**158,000**
Depletion	**1,106,544**
Amortization of financing expenses	**60,197**
Deferred income taxes	**172,000**
Working capital provided from operations	**1,204,165**
Mortgage receivable becoming current	**5,757**
Increase in long-term debt	**15,182,625**
Proceeds on sale of property and equipment	**3,047,636**
Reduction of advances to Class "B" Common Shareholders	**1,085,662**
	20,525,845
Use of funds:	
Reduction of long-term debt	**15,450,116**
Additions to property and equipment	**2,730,607**
Dividends paid on Class "B" Common Shares	**1,085,662**
Dividends paid on Preferred Shares	**11,600**
Financing expenses	**150,000**
Advances to Class "B" Common Shareholders	**455,205**
Other	**48,809**
	19,931,999
Increase in working capital	**593,846**
Working capital deficiency, beginning of period	**1,477,692**
Working capital deficiency, end of period	**$ 883,846**

See accompanying notes.

RANCHMEN'S RESOURCES (1976) LTD.

Notes to Consolidated Financial Statements

DECEMBER 31, 1977

1. Significant Accounting Policies

a) Formation of Company:

On January 4, 1977, the Company was formed under the laws of the Province of Alberta as a result of an amalgamation between Ranchmen's Resources (1975) Ltd., and its wholly owned subsidiaries (Ranchmen's Development Ltd. and Ranchmen's Minerals Ltd.) and Davoil Natural Resources Limited, Bluemount Resources Ltd. and Ark Explorations Limited.

Each shareholder of the amalgamating companies received shares of the Company on the following basis:

Amalgamating Company	Shares of amalgamating Company held prior to amalgamation	Shares of Company received upon amalgamation
Ranchmen's Resources (1975) Ltd.		
— common	1	1
— preferred	1	1
Bluemount Resources Ltd.		
— common	3	2
Davoil Natural Resources Limited		
— common	6	1
Ark Explorations Limited		
— common	13	1

Under the purchase method of accounting, Ranchmen's Resources (1975) Ltd. was considered the purchaser. Accordingly, the excess of the fair market value of the shares of the other companies, at the date of amalgamation, over the underlying net book value, amounting to $5,971,616 has been included under the heading "Oil and gas properties" (to be depleted on the composite unit of production basis) and credited to contributed surplus of the Company.

Upon amalgamation, the common shares which Ranchmen's Resources (1975) Ltd. owned in Ranchmen's Development Ltd., Ranchmen's Minerals Ltd., Davoil Natural Resources Limited, Bluemount Resources Ltd. and Ark Explorations Limited were cancelled.

Amalgamation costs aggregating $79,263 were written off to deficit.

Details of the amalgamation (fully reported on January 4, 1977) are as follows:

	Ranchmen's Resources (1975) Ltd. and Wholly-owned Subsidiaries	Davoil Natural Resources Limited	Bluemount Resources Ltd.	Ark Explorations Limited	Total
Net current assets acquired	$(5,891,951)	270,007	4,141,229	3,023	(1,477,692)
Investment in amalgamating companies	11,596,981	—	—	—	11,596,981
Net property, plant and equipment	9,252,937	336,432	2,884,961	692,712	13,167,042
Real estate, held for resale	—	—	—	363,415	363,415
Due from Class "B" shareholders	630,457	—	—	—	630,457
Mortgage receivable	—	—	—	276,786	276,786
Other assets	399,103	32,814	22,950	7,286	462,153
	15,987,527	639,253	7,049,140	1,343,222	25,019,142
Deduct long-term liabilities assumed:					
Bank loans	10,367,375	—	—	535,150	10,902,525
Term debenture	400,000	—	—	—	400,000
Mortgage payable	—	—	—	44,334	44,334
Due to Canadian Oil & Gas Fund Ltd.	543,442	—	—	—	543,442
Deferred income taxes	110,274	40,000	—	83,800	234,074
	11,421,091	40,000	—	663,284	12,124,375
	$ 4,566,436	599,253	7,049,140	679,938	12,894,767

Amalgamation adjustments:	
Elimination of the net book value of the shares owned by Ranchmen's Resources (1975) Ltd. in amalgamating companies	(11,596,981)
Excess of the fair market value of the shares in the amalgamating companies over their underlying net book value	5,971,616
Write-off of amalgamation costs to deficit	(79,263)
Net assets acquired	$7,190,139
Represented by:	
Share Capital	$6,146,409
Contributed surplus	1,737,590
Deficit	(697,283)
Minority interest	3,423
	$7,190,139

b) Principles of Consolidation:

The consolidated balance sheet includes the accounts of Ranchmen's Resources (1976) Ltd. and its wholly-owned subsidiaries, Bluemount Minerals Inc., Bluemount Minerals Ltd., Brady Oil and Gas Limited and that company's 60% owned subsidiary, Greenvalley Holdings Limited. All significant intercompany transactions have been eliminated on consolidation.

Accounts of the United States subsidiary have been converted to Canadian funds on the following basis:

Current assets and current liabilities — at the exchange rate of the balance sheet date.

Income and expenses — at the average exchange rate for the year, except for depreciation and depletion which are at the historic exchange rate.

Other assets — at the exchange rate in effect on the date of the transaction.

c) Property and Equipment:

The Company follows the full cost method of accounting whereby all costs and expenses of exploring for and developing oil and gas reserves are capitalized, and these costs, together with production equipment, are being depleted or depreciated on the composite unit of production method based on estimated proven reserves as determined by independent engineers. Proceeds on minor property sales are credited to the net book value of property and equipment without recognizing any gain or loss on disposition. Gains or losses on major property sales are recognized in the statement of earnings and deficit for the year.

d) Financing Expenses:

The Company is amortizing its financing costs over an eight year period.

2. Long-term Debt:

Although the bank loans, which bear interest at 1.5% above prime bank rate, are payable on demand, under the agreed terms of repayment $400,000 will be repaid within the next twelve months. The bank loans are secured by an assignment of oil and gas properties under Section 82 of the Bank Act and by a floating charge debenture on the Company's assets, both present and future, in the amount of $1,749,135. This debenture imposes certain restrictions on capital expenditures.

The Floating Rate Secured Serial Income Debentures bear interest at 1.5% plus one-half of the prime bank rate with a minimum of 5.5% and a maximum of 7.5% per annum payable semi-annually to the extent of available profit, with a provision for deferral, if necessary. The debentures have been issued in five series of $2,000,000 principal amounts, maturing on each of December 22 of 1981, 1982, 1983, 1984 and 1985. The debentures are secured by a first fixed mortgage on certain oil and gas properties and a floating charge on all assets, and are redeemable by the Company on or after December 19, 1979 with accrued interest to the date of redemption. The Company has issued warrants entitling the subscriber to purchase shares of the Company (see Note 3).

The amount of $543,442 payable to Canadian Oil & Gas Fund Ltd., is due in January, 1978 and bears interest at prime bank rate plus 1%.

The mortgage payable which bears interest at 11.75%, is repayable in monthly instalments of $1,040, principal and interest.

3. Share Capital:

On January 4, 1977 the Company issued the following shares, in accordance with the Amalgamation Agreement,

Preferred Shares:	
14,500 Series "B" 8% Convertible Cumulative Redeemable Preferred Shares	$145,000
Common Shares:	
1,070,070 Class "A" Common Non-Voting Shares	$4,512,085
227,602 Class "B" Common Non-Voting Shares	$1,138,012
70,262 Class "C" Common Voting Shares	$ 351,312

The Series "B" 8% Convertible Cumulative Redeemable Preferred Shares are redeemable at par at the option of the Company after June 30, 1978 and after June 30, 1980 at the option of the holder thereof. The Series "B" Preferred Shares are convertible by the holder at certain specified dates into 39,200 Class "C" Common Voting Shares.

The Company has reserved 85,328 Class "A" Common Non-Voting Shares and 3,552 Class "C" Common Voting Shares, pursuant to an agreement entered into by Cogfac Resources Ltd. (a predecessor company) on June 24, 1975 which may be issued and exchanged for 40,000 10% Series "A" Preferred Shares (having a nominal or par value of $10 per share) of Canadian Oil & Gas Fund Ltd. In addition, the Company has reserved 39,200 Class "C" Common Voting Shares for conversion of the Series "B" Preferred Shares.

The Company has reserved 23,334 Class "A" Common Non-Voting Shares pursuant to certain option agreements entered into by Bluemount Resources Ltd., whereby the optionee could purchase 35,000 shares of that company at any time prior to March 15, 1979 for $5 per share. The Company has reserved 100,000 Class "A" Common Non-Voting Shares pursuant to a share purchase warrant indenture with the income debenture holders whereby the warrant holders may purchase 100,000 shares at any time prior to December 19, 1979, 1981, and 1983 at $3.50, $4.00 and $5.00 per share respectively.

By a special resolution of the shareholders, the authorized capital of the Company was increased during the year in the following manner:

	December 31	January 4
Preferred shares with a nominal or par value of $10 per share	1,400,000	400,000
Common shares without nominal or par value:		
Class "A" common non-voting shares	4,400,000	1,400,000

4. Commitment and Contingent Liability:

a) The Company has entered into a 25 year management agreement with a shareholder, Canadian Oil & Gas Fund Ltd., wherein the Company will pay reasonable administrative costs and 5% of the cost of property acquired and of shares of corporations acquired on behalf of the Company.

b) In 1977 the Company was sued in the United States District Court by certain minority shareholders of Ark Explorations Limited (a predecessor company). The plaintiffs alleged non-compliance by the Company with the provisions of the Securities Act of 1933 (U.S.) and the Securities Exchange Act of 1934 (U.S.). The claim is for an order directing the Company to purchase shares of the company held by the plaintiffs for $438,100 (U.S.) and for exemplary damages in the amount of $1,000,000 (U.S.). The Company has denied the plaintiffs' claim and has been advised by U.S. counsel that it has good and meritorious defence to both claims, and in particular the claim for exemplary damages has little or no merit. The Company has filed a Counterclaim against the plaintiffs alleging inducement, misrepresentations and fraud under the Securities Exchange Act of 1934 (U.S.) and claiming damages of not less than $250,000 plus costs.

5. Anti-Inflation Act:

Effective October 14, 1975, the Federal Government enacted a program of restraint on prices, profits, dividends and compensation. The Company does not come under the mandatory aspects of the program other than those provisions pertaining to the payment of dividends. In the opinion of management, the Company has in all material aspects, complied with the guidelines since this announcement.

6. Remuneration of Directors and Senior officers:

The aggregate management fees and remuneration paid to directors and senior officers (which includes the five highest paid employees) for the period ended December 31, 1977 was approximately $210,400.

7. Deferred Income Taxes:

The accompanying consolidated statement of earnings and deficit shows a provision for income taxes of $172,000 in relation to a loss before income taxes of $120,576. An income tax provision is required despite a pretax loss because certain expense items (income items) which are reflected in the accompanying statement of earnings and deficit are not deducted (included) in the computation of taxable income as shown below:

Loss before income taxes	$ 120,576
Add non-allowable items, including crown royalties and depletion on assets which are not deductible for income tax purposes	1,411,914
Deduct gain on disposal of shares	(21,004)
	1,390,910
Income for purposes of income tax calculations before earned depletion and resource allowance	1,270,334
Deduct:	
Earned depletion allowance	159,250
Federal resource allowance	636,361
Income for purposes of income tax provision	$ 474,723

Auditors' Report to the Shareholders

We have examined the consolidated balance sheet of Ranchmen's Resources (1976) Ltd. as at December 31, 1977 and the consolidated statements of earnings and deficit and changes in financial position from the date of amalgamation, January 4, 1977, to December 31, 1977. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the company as at December 31, 1977 and the results of its operations and the changes in its financial position for the period then ended in accordance with generally accepted accounting principles.

Calgary, Canada
April 21, 1978

Peat, Marwick, Mitchell & Co.
Chartered Accountants

RANCHMEN'S
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